

DIRECT TESTIMONY

of

Thomas Q. Smith  
Accountant

Accounting Department  
Financial Analysis Division  
Illinois Commerce Commission

Petition for Approval of  
Agreement with an Affiliated Interest

Central Illinois Light Company

Docket Nos. 00-0815/00-0816  
(Consolidated)

March 30, 2001

1    1.    **Q.    Please state your name and business address.**

2            A.    My name is Thomas Q. Smith. My business address is 527 East Capitol  
3            Avenue, Springfield, Illinois 62701.

4

5    2.    **Q.    By whom are you employed and in what capacity?**

6            A.    I am an Accounting Supervisor in the Accounting Department of the  
7            Financial Analysis Division of the Illinois Commerce Commission.

8

9    3.    **Q.    What is the function of the Accounting Department of the Illinois  
10           Commerce Commission?**

11           A.    The Department's function is to monitor the financial condition of public  
12           utilities as part of the Commission's responsibilities under Article IV of the  
13           Public Utilities Act and to provide accounting expertise on matters before  
14           the Commission.

15

16    4.    **Q.    Please describe your background and professional affiliation.**

17           A.    In 1974 I received a Bachelor of Arts Degree in Accounting from Michigan  
18           State University. I am a Certified Public Accountant licensed to practice in  
19           Illinois, Michigan, and Wisconsin. My prior accounting experience includes  
20           seven years as an auditor with the Michigan Public Service Commission.

21           Subsequently, I was employed for three years by Wisconsin Southern Gas

22           Company in the initial capacity of Senior Accountant - Rate specialist and

23 later as Controller. I am a member of the American Institute of Certified  
24 Public Accountants.

25  
26 **5. Q. Have you previously testified before regulatory bodies?**

27 A. Yes, I have testified on several occasions before the Illinois Commerce  
28 Commission, the Michigan Public Service Commission, and the Public  
29 Service Commission of Wisconsin.

30  
31 **6. Q. What are your responsibilities in this case?**

32 A. I have been assigned to this case by the Director of the Accounting  
33 Department of the Illinois Commerce Commission. I am to review Central  
34 Illinois Light Company's (CILCO or the Company) filing as it relates to  
35 accounting, PGA, and FAC issues.

36  
37 **7. Q. What is the purpose of your testimony in this proceeding?**

38 A. The purpose of my testimony is to address the appropriate accounting  
39 procedures to be followed by CILCO to properly reflect its proposal in this  
40 Docket.

41  
42 **8. Q. Are you presenting any Schedules as part of this testimony?**

43 A. Yes, I am presenting the following Schedules as part of ICC Staff Exhibit  
44 3.0.

45 Schedule 3.1 - Company Proposed Journal Entries  
46 Schedule 3.2 - Staff Proposed Journal Entries

47

48 **9. Q. Have you reviewed the Company's petition and pre-filed testimonies?**

49 A. Yes, I have.

50

51 **10. Q. Briefly, what is your understanding of the Company's proposal in this**  
52 **Docket?**

53 A. Based on review of the Company's petition and testimonies, it is my  
54 understanding that AES Medina Valley Cogen, L.L.C.(Medina), a wholly-  
55 owned subsidiary of CILCO's parent AES Company, will own a power plant  
56 which will supply electricity, steam, and chilled water to CILCO for delivery  
57 to a Caterpillar plant in Mossville, Illinois. Any electricity generated by  
58 Medina which is not needed by Caterpillar will be retained in CILCO's  
59 distribution system for delivery to its general customer base. As part of the  
60 relationship, CILCO will purchase natural gas for Medina and deliver it to  
61 the Mossville plant.

62

63 **11. Q. Does the process which you have described reflect utility, or non-**  
64 **utility, operations?**

65 A. I have not made that determination. Relative to this question, Staff  
66 witnesses David Borden and Dennis Anderson are addressing the form of

the operations of CILCO's proposal. My concern is to identify the underlying substance of the operations in order to know which of the possible accounting alternatives is appropriately applied to account for the Company's plan.

**12. Q. Are you addressing only one possible view of the nature of operations?**

A. No. I am addressing several views. The Company appears to suggest that the relationship among CILCO, Medina, and Caterpillar reflects non-utility operations although they propose that CILCO, rather than Medina, will be responsible for the acquisition of fuel supply for the power plant. Staff witness Borden recommends that if CILCO provides transportation service, then CILCO can neither supply gas nor be the customer of record; in the alternative, CILCO could be the supplier of gas using approved tariffs, and providing no favorable treatment to Medina. ICC Staff Exhibit 1.0, p. 16. Staff witness Anderson is of the opinion that if CILCO acquires the supply of gas for Medina, then CILCO should sell that gas to a customer other than CILCO, in the same manner that it sells gas to other customers. ICC Staff Exhibit 2.0, p. 6.

87 **13. Q. From an accounting perspective is it important that the operating**  
88 **nature of the Medina plant be determined to be either utility, or non-**  
89 **utility, in nature?**

90 A. Accounting procedures, as prescribed by the Commission, are intended to  
91 address both utility and non-utility aspects of any Company's operations. It  
92 is not important from an accounting perspective that operations be labeled  
93 as either, utility, or non-utility. However, if the appropriate accounting  
94 procedures are to be applied, it is important to know the nature of  
95 operations regardless of any specific label.

96  
97 Because we do not know how the Commission will rule relative to the  
98 nature of the operations proposed by CILCO, my testimony is intended to  
99 address appropriate accounting procedures for the various possibilities.  
100

101 **14. Q. What is your understanding of CILCO's intended accounting entries**  
102 **for recording its transactions with Medina and Caterpillar?**

103 A. CILCO, in response to Data Request TQS 1.1, has provided accounting  
104 entries which reflect its intended method of accounting for the transactions  
105 contemplated by the Medina arrangement. I have reproduced the  
106 significant entries on ICC Staff Exhibit 3.0, Schedule 3.1, Company  
107 Proposed Accounting Entries.

108

109 **15. Q. Do you agree with the Company's proposed accounting entries?**

110 A. No, I do not. One of the goals of accounting is to reflect the financial  
111 results of the actual physical operations of an entity. In this case the  
112 Company is proposing that it purchase natural gas for use by another  
113 entity. Consequently, CILCO's accounting entries should indicate that it is  
114 purchasing gas from a supplying entity and selling it to a purchasing entity.

115

116 Journal entry 1 on Schedule 3.1 indicates that the Company is purchasing  
117 natural gas from an outside entity. I agree with this accounting entry  
118 because it reflects actual operating conditions. Journal entry 2 indicates  
119 that CILCO will be transferring the gas from its gas operations to its  
120 electric operations. I disagree with journal entry 2.

121

122 **16. Q. Is it correct that CILCO will eventually obtain electricity from Medina**  
123 **to resell to Caterpillar and various other customers?**

124 A. That is a correct description of the operations contemplated by the contract  
125 between CILCO and Medina.

126

127 **17. Q. In view of the fact that the electricity resulting from the consumption**  
128 **of the natural gas will revert to CILCO's distribution system, would it**

129 **be simpler to directly assign the gas cost from CILCO's gas**  
130 **department to CILCO's electric department?**

131 A. It might be simpler, but it could also be misleading. As explained in the  
132 testimonies of the other Staff witnesses, this transaction as proposed by  
133 the Company, is complicated and not a normal utility practice. It is  
134 therefore important that the actual costs which will reflect the operations of  
135 the relationships among CILCO, Medina, and Caterpillar, be separated and  
136 easily traced as they provide benefits and identify obligations of CILCO.

137  
138 **18. Q. What journal entry do you propose as a replacement for the**  
139 **Company's proposed journal entry 2?**

140 A. Rather than treating the delivery of gas to Medina as a transfer to CILCO's  
141 electric department, the proper entry would be a debit to account 142,  
142 accounts receivable, and a credit to various revenue accounts. This entry  
143 is shown as journal entry 2 on ICC Staff Exhibit 3.0, Schedule 3.2, Staff  
144 Proposed Journal Entries. By recording the delivery of gas to Medina as a  
145 sales transaction in the accounts of CILCO, we are acknowledging that  
146 CILCO is providing a service to Medina to enhance Medina's ability to  
147 produce electricity, steam, and chilled water which Medina can then sell to  
148 its customer, CILCO.



150 **19. Q. Under the Company's proposal, journal entry 2 would allocate the**  
151 **cost of gas needed to generate electricity, steam, and chilled water**  
152 **for sale to Caterpillar as fuel expense in account 501. Considering**  
153 **that CILCO will sell services to Caterpillar, is it reasonable that there**  
154 **will be costs associated with the provision of the services?**

155 A. CILCO will incur costs in order to sell services to Caterpillar. The cost of  
156 providing service will include the cost of gas. Under Staff's proposal, the  
157 cost of gas will be charged to CILCO by Medina when Medina sells the  
158 electricity, steam, and chilled water to CILCO for resale to Caterpillar.  
159 Schedule 3.2, journal entry 4 illustrates that the cost of gas will be charged  
160 back to CILCO by a debit entry to account 555, purchased power expense  
161 and a credit entry to account 234, accounts payable, associated  
162 companies. The combination of journal entries 2 and 4 on Schedule 3.2  
163 ensures that the complete transaction, that is, sale of the gas by CILCO to  
164 Medina, and purchase of the finished product by CILCO from Medina, will  
165 be reflected in the financial records of CILCO. There will not be any  
166 confusion regarding which entity is using the natural gas to turn the  
167 generators which are producing the electricity.

169 **20. Q. Are you familiar with the tolling agreement between CILCO and**  
170 **Medina which is under consideration in this Docket?**

171 A. Yes, I am familiar with the tolling agreement.

172

173 **21. Q. Is the tolling agreement significant with regard to the journal entries**  
174 **which you are proposing?**

175 A. The tolling agreement establishes the legal form of the relationship  
176 between CILCO and Medina. While legal form might be important, my goal  
177 is to propose accounting entries which reflect the substance of the  
178 operating relationship between CILCO and Medina.

179

180 According to the tolling agreement, Medina is being paid to convert  
181 CILCO's natural gas to electricity, steam, and chilled water for CILCO.  
182 From a legal perspective I assume that Medina will not hold legal title to the  
183 natural gas. However, from an operational perspective, gas will move from  
184 CILCO's gas transportation system into facilities which are owned by  
185 Medina. Medina will then use facilities which are owned by Medina, to  
186 make electricity, steam, and chilled water using its own resources,  
187 including the natural gas. The products which are manufactured by Medina  
188 will be delivered to CILCO for sale to Caterpillar and other customers.

189

190 The operating relationship between Medina and CILCO will mirror CILCO's  
191 operating relationship with other non-affiliated suppliers of wholesale  
192 energy. Consequently, the journal entries which I am proposing are

intended to reflect the operational relationship between CILCO and Medina as if they were not affiliated. It is my intent that the journal entries not obscure the physical relationship, regardless of the legal technicalities.

**22. Q. Will Medina incur cost other than natural gas to produce electricity, steam, and chilled water?**

A. Based on the Company's proposed journal entries as shown on Schedule 3.1, Medina will incur costs other than fuel. Journal entry 3 shows that CILCO plans on recording these other costs in account 506, miscellaneous steam production expense.

**23. Q. Do you agree with the Company's proposed method of accounting for the non-gas expense?**

A. I disagree with the Company. CILCO is not producing any steam. It is unreasonable to record non-gas expense that is used by a different company as miscellaneous steam production expense of CILCO.

Because CILCO is buying a service, or commodity, it is reasonable to record the non-gas cost of production as purchased power expense in account 555. An offsetting credit would be made to account 234, accounts payable, associated companies. This entry is shown on Schedule 3.2 as journal entry 3. Recording the miscellaneous generation expenses as a

215 purchased power expense of CILCO reflects the buyer/seller relationship  
216 of CILCO and Medina.  
217

218 **24. Q. How is the Company proposing that the gas cost be treated for PGA**  
219 **purposes?**

220 A. The Company is proposing that the invoice cost of gas purchased for  
221 Medina be excluded from the cost of gas to be recovered through the PGA  
222 clause. It is my opinion that the Company's proposal is reasonable if it is  
223 determined that CILCO's general customer base should neither benefit nor  
224 suffer consequences caused by the relationship of CILCO and Medina.  
225

226 It is my understanding, based on review of Dennis Anderson's Testimony,  
227 ICC Staff Exhibit 2.0, that it is his position that the gas purchased by  
228 CILCO for the Medina operations should be treated like all other gas sales.  
229 The gas should be sold to a customer under Rate 700. Given this  
230 scenario, the Medina gas should be treated like system gas for PGA  
231 purposes. Gas would be recovered from the Customer, presumably  
232 Caterpillar at a PGA rate equal to that charged to other Rate 700  
233 customers.  
234

235 **25. Q. What is the impact of the Company's proposal on CILCO's FAC?**

236           A.     The amount to be included in FAC cost to be recovered from customers  
237                   should include only the invoice cost of gas delivered to Medina. If the  
238                   invoice cost of gas to Medina equals the original invoice cost to CILCO,  
239                   then the original invoice cost should be included in the FAC. If the invoice  
240                   cost of gas to Medina equals a system average cost of gas, then this  
241                   average cost of gas should be included in the FAC.

242  
243                   Once the cost of fuel has been identified based on the previous paragraph,  
244                   and charged to CILCO's account 555, the cost of fuel to generate energy  
245                   sold to Caterpillar should be deducted from total fuel cost. The cost of fuel  
246                   to generate energy sold to Caterpillar, should not be recovered through the  
247                   FAC.

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249  
250  
251  
252   **26.   Q.     As one condition of approval of the petition, Mr. Borden proposes**  
253                   **that Medina be required to secure its own supply of gas. ICC Staff**  
254                   **Exhibit 1.0, p 16. How would this proposal impact CILCO's**  
255                   **accounting, PGA, and FAC?**

256           A.     If Medina were to obtain its own natural gas supply, the cost of gas would  
257                   not be recorded as a cost for any purpose by CILCO. When energy is

delivered to CILCO, the cost of that energy would be recorded as purchased power expense in account 555 and a credit entry would be made to account 234, accounts payable, associated companies. The amount which would be recoverable through the FAC would be calculated as it would for any other purchased power supplier. Whether sales and costs to Caterpillar would be included in the FAC would depend upon the tariff under which Caterpillar is served.

If CILCO provided transportation service, Medina would be viewed as any other transportation customer. Medina would be charged by CILCO according to the appropriate transportation tariff, T-7. The costs and revenues from Medina would be recorded in the manner prescribed by the tariff and Uniform System of Accounts. More specifically, accounts receivable would be debited and transportation revenues would be credited.

**27. Q. Staff witness Anderson is proposing an alternative by which Medina would be served as a customer under one of CILCO's large industrial tariffs. Do you have comments relative to this proposal?**

**A.** If Medina were served by CILCO under a general industrial tariff, Medina would be treated like all other customers for accounting and PGA purposes.

279

280   **28.   Q.    Is it your understanding that the Public Utilities Holding Company Act**  
281                   **requires the Commission to find that the Commission has sufficient**  
282                   **access to books and records of the utility and affiliates and**  
283                   **subsidiaries, and sufficient regulatory authority and resources over**  
284                   **the utility?**

285           A.    That is my understanding. It is my understanding that the Commission, in a  
286                   letter dated March 10, 1999, certified to the SEC with regard to the  
287                   CILCO/AES merger that, "The Illinois Commerce Commission...(has) the  
288                   authority and resources to protect Illinois consumers in accordance with the  
289                   Illinois statutes..." and that the Commission "...intend(s) to exercise such  
290                   authority." It is my opinion that the Commission continues to have  
291                   adequate authority and resources as described in the letter to the SEC.

292

293   **29.   Q.    Does this conclude your direct testimony?**

294           A.    Yes, it does.

CILCO  
Company Proposed Journal Entries  
For Purchase of Electricity from AES Medina

Dockets 00-0815  
00-0816  
ICC Staff Exhibit 3.0  
Schedule 3.1

J.E. No.	Acct. No.		<u>Debit</u>	<u>Credit</u>
1		Record purchase of natural gas for Medina		
	804	City Gate Purchases	\$ 1,068,750	
	232	Accounts Payable		\$ 1,068,750
2		Record sale of natural gas to CILCO's electric Department - operation of Medina		
	501	Fuel	\$ 1,108,750	
	484	Interdepartmental Sales - cost of gas		\$ 1,068,750
	484	Interdepartmental Sales - other		\$ 40,000
3		Record expenses for the operation of Medina owned generators		
	506	Miscellaneous steam production	\$ 998,008	
	234	Accounts Payable - Assoc. Cos.		\$ 998,008
4		Record sales of utility services to Caterpillar		
	142	Accounts Receivable	\$ 1,686,221	
	501	Fuel		\$ 591,280
	442	Comercial and Industrial Sales		\$ 932,728
	453	Other Electric Revenue - Steam		\$ 31,161
	456	Other Electric Revenue - Chilled Water		\$ 101,053
	440 to			
	448	Operating Revenues		\$ 30,000

Source: Response to Data Request TQS 1.01



CILCO  
Staff Proposed Journal Entries  
For Purchase of Electricity from AES Medina

Dockets 00-0815  
00-0816  
ICC Staff Exhibit 3.0  
Schedule 3.2

J.E. No.	Acct. No.		<u>Debit</u>	<u>Credit</u>
1		Record purchase of natural gas for Medina		
	804	City Gate Purchases	\$ 1,068,750	
	232	Accounts Payable		\$ 1,068,750
2		Record sale of natural gas to Medina		
	146	Accounts receivable - Associated Cos.	\$ 1,108,750	
	481	Commercial and Industrial Sales		\$ 1,068,750
	489.2	Revenues from transportaion		\$ 35,000
	481	Commercial and Industrial Sales		\$ 5,000
3		Record expenses for the operation of Medina owned generators		
	555	Purchased Power Expense	\$ 998,008	
	234	Accounts Payable - Assoc. Cos.		\$ 998,008
4		Record fuel expense of Mendina production		
	555	Purchased Power Expense	\$ 1,108,750	
	234	Accounts Payable - Associate Cos.		\$ 1,108,750
4		Record sales of utility services to Caterpillar		
	142	Accounts Receivable	\$ 1,686,221	
	xxx	Various Revenue Accounts		\$ 591,280
	442	Comercial and Industrial Sales		\$ 932,728
	453	Other Electric Revenue - Steam		\$ 31,161
	456	Other Electric Revenue - Chilled Water		\$ 101,053
	440 to			
	448	Operating Revenues		\$ 30,000